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March 8, 2013

Mr. Eddie Streator
Designated Federal Officer
BIA, Wewoka Agency
P.O. Box 1540
Seminole, OK 74818

e-copy: osageregnetg@bia.gov

Dear Mr. Streator:

The Osage Producers Association Board has made me aware of potential changes in the CFR, Title 25, Chapter 1, Part 226 for Osage County oil and gas operations. Compared to the existing regulations several of the proposed changes appear to be a little radical, some unfair, some not necessary and some reasonable.

I have been a Petroleum Engineer for 49 years and have worked in most of the producing areas of the United States, including Osage County as an engineer and manager of operating companies. My father and his father had careers working in the Osage as Superintendents responsible for drilling and completing hundreds of wells, so I feel that I have some knowledge of operations in this rather unique area of the Mid-Continent.

Since my wife comes from a large ranching family in Osage County and has a small ranch of her own, I have some knowledge from the landowner's perspective.

The following are my comments on a list of 12 items identified by the Osage Producers Association Board as items of most concern:

1. "Bonding requirements will be on a per well basis, not a quarter-section basis, and not less than \$10,000/well. The requirement will cap the number of wells to be bonded at 20."

This item is not unreasonable. It could work to diminish the number of Operators willing to take on the large units and field areas with lots of unplugged wells. In the past smaller Operators were able to obtain leases, which contained many abandoned but unplugged wells, and identify for the BIA only those wells they wished to attempt to produce. For decades, an Operator could obtain a lease with abandoned wells that they were able to return to production. The Operator made money and the Tribe made money. That was good. However, there comes a time when Operators can no longer workover these old wells because of mechanical problems. Having said that, I know of wells that are over 100 years old and still producing income for both the Tribe and the Operator.

2. "Oil or gas lease rental rates will increase from \$1 to \$10/acre and oil and gas lease rates will go from \$2 to \$20/acre."

The proposed rental rates are an extreme increase and they depart from the generally accepted practice in the industry. This is a bad proposal and unfair to the Operators.

3. "Termination of leases for non-production in "paying quantities" will take place in 90 days, with a request after 45 days of non-production for relief in writing for a "temporary suspension of operations"."

I know of a couple of Operators who lost their shut-in leases after they remained inactive for more than 6 months. From an Operators viewpoint, allowing for inactivity up to 6 months is a lot more workable for the Operator without inconveniencing the Tribe or BIA. Changing this practice is definitely not a good idea.

4. "The Superintendent may force an Operator to drill, or modify existing well(s), if the Superintendent determines that leases are drained by offsetting wells."

This has been a practice that has been used in the past by the Superintendent. It is a practice outside the Osage Nation referred to as "protecting correlative rights". If the Superintendent is demanding an Operator drill an additional well/s or workover an existing well/s there should be technical support for the Superintendent's demand and an opportunity for rebuttal by the Operator.

5. "Oil royalty rates (payment) will be based on NYMEX pricing - generally \$3 higher than the posted price. Because no one receives NYMEX pricing, this pricing guarantees that the producers will pay a royalty on an oil price not attainable."

This amounts to an increase in royalty rate because the Operator cannot receive the NYMEX price. This proposed rule is wrong, unfair to the producers, and probably can be successfully challenged in Federal Court. It proposes to change the basic oil and/or gas contract between the Department of the Interior and the producer without any compensation.

6. "Producers will be required to furnish copies of run tickets on a quarterly basis, regardless of the fact that the BIA currently receives these tickets from the purchaser."

This rule seems to be a rule of redundancy aimed at the producer. The run tickets supplied by the producer will sit in boxes in a BIA storage building and never be used except for maybe an occasional audit of a lease to justify the rule. If there is a bonafide need for the producer copy of the run tickets we should, of course, send them to the BIA each month.

7. "Commencement money for drilling a well is being increased from \$300 to \$2,500. Tank fee rates are being increased from \$100/tank to \$500/tank."

This proposed increase in Commencement money is probably reasonable, as long as it continues to be a credit toward total well damages.

8. "Before a tank of oil may be called in to the purchaser, the Superintendent shall be notified. A \$500 fine is the penalty for failure to follow this procedure."

I don't presume to know why this rule is needed. I am aware that many operators do not even gauge their tanks. . . probably because the daily oil production is so small. However, daily

tank gauging is what I was taught is a "best practice" for an operator. Why doesn't the BIA apply this rule to the operators whose operational practices needs such personal attention and let the rest of us alone.

9. "Lessee shall maintain for six (6) years a record of seal numbers and shall document on which valves or connections they were used as well as when they were installed or removed."

This is generally a bad idea that the BLM started on Indian and Federal leases outside Osage County. It probably will turn out to be a rule enforced on those producers that follow the rules but not enforced on the outlaw operators that won't.

10. "A "site security plan" must be operated and maintained for each tank battery to ensure the accountability of the oil production."

Site Security Plans will not ensure the accountability of the oil production of a lease. A perfectly executed plan could ensure that the operator could show a theft of oil had occurred from one or more of his tanks but not who took it. The BIA could assess the operator a penalty equal to the royalty value of the oil stolen but not prevent another event in the future. This would probably work to absolve the BIA of any accusations they are not properly managing the Osage oil estate though. It would be interesting to know just how many thefts of oil occur on the Osage Nation leases each year or at least how many are reported. Chances are, stolen oil is more than likely sold within Osage County and the royalty is paid to the tribe anyway.

11. "Failure to mark well and tank batteries with appropriate signage is subject to a \$500/day fine."

There should be a warning period, where an Operator is notified by the BIA that a sign is missing. As a long-time Operator I know many of our signs disappear and the pumpers do not always let us know they are gone."

12. "If oil for the preceding month exceeds \$200/barrel, rental rates due will increase by the percentage that oil increases over \$100."

Why increase the monthly administrative work-load for the Operator and the BIA with this kind of money-grubbing rule? The BIA should review the rental rates every 5 years or so and announce an increase, if that is appropriate.

In summary, I believe the CFR for oil and gas operations in the Osage Nation may be dated but I don't think they need the attention that they are currently getting. The Osage Mineral Council needs to resist the temptation to gouge the producer for a few extra dollars at every opportunity because it probably hurts the tribe more that it helps. The BIA isn't sufficiently staffed to take care of the current workload much less create more work for them. In addition, bringing the practices of the BLM into the Osage is a bad idea. And finally, a hard working, experienced Superintendent is necessary to handle the complex job of Superintendent of the Osage Indian Agency. It is a full-time job requiring knowledge of legal affairs of the tribe, oil

and gas operations and federal regulations affecting these operations, as well as the charm of a snake oil salesman.

Very truly your,

Grayhorse Operating, Inc.
Operator and Contract Operator, Osage County, OK

A handwritten signature in cursive script that reads "Charles A. Ellis". The signature is written in black ink and is positioned above the printed name.

Charles A. Ellis